Supreme Court, U.S.
FILED
FEB 24 2015
OFFICE OF THE CLERK

Nos. 13-1421 & 14-163

IN THE

Supreme Court of the United States

BANK OF AMERICA, N.A.
Petitioner
v.
DAVID B. CAULKETT
Respondent

BANK OF AMERICA, N.A.
Petitioner
v.
EDELMIRO TOLEDO-CARDONA
Respondent

On Writs of Certiorari to the
United States Court of Appeals
for the Eleventh Circuit

BRIEF OF PROFESSOR MARGARET HOWARD AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICA[1]

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SUMMARY OF ARGUMENT

Dewsnup v. Timm, 502 U.S. 410 (1992), was wrongly decided and should be overruled. Its statutory methodology ignored both the plain meaning of the Bankruptcy Code and established principles of statutory construction. The outcome might be defensible had it vindicated congressional policies, but it contradicts them instead.

Dewsnup's result was not necessary to preserve creditors' rights to appreciation, whether during the case or later. Property rarely appreciates

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[1] No party or counsel for a party authored this brief in whole or in part or made a monetary contribution to its preparation or submission. Expenses for the preparation and submission of this brief were met exclusively from research funds available to Amica.

Counsel of record for petitioner and respondent granted permission for the filing of this brief.

during a chapter 7 proceeding because of its short duration. If appreciation does occur, lienholders' interests are fully protected by proper valuation as of the proper time. Thereafter, creditors can capture appreciation by reinvesting in a rising market. Institutional lenders may not be able to hold property for appreciation anyway, for statutory and regulatory reasons.

Congress enacted a targeted provision to deal with undersecured creditors' rights to appreciation—section 1111(b). It does not extend to creditors whose liens are "of inconsequential value," and, even when applicable, it does not assure creditors of any more than the present value of collateral supporting their claims.

Dewsnup erroneously believed that liens pass through bankruptcy unaffected. They do so only if bankruptcy's substantial avoiding powers are not brought to bear.

Under this Court's constitutional precedents, secured creditors must receive the value of collateral available for their claims, but not the collateral itself. That understanding is foundational in bankruptcy. The Code follows a "priority model" under which lienholders are assured the value of their secured claims, but not property rights in particular collateral.

Numerous sections of the Code, applicable in both liquidations and reorganizations, reflect the priority model: section 361, which lists ways of providing adequate protection, protects only value, not property rights; section 364(d) overrides secured

creditors' property rights by permitting liens to be demoted if necessary postpetition credit cannot otherwise be obtained; section 722 permits debtors to redeem certain property, eliminating encumbrances by paying the collateral's value; section 506(b) allows oversecured creditors to claim postpetition interest, but only up to the value of available collateral; and plan confirmation requirements in the reorganization chapters require payment only of the present value of secured claims.

When Congress intended to make exceptions, they are specific and narrowly drawn.

Even if *Dewsnup* is not overruled, it should not be extended to protect liens devoid of supporting value. *Dewsnup* protects "secured" claims and no claim is secured, as defined in section 506(a), in the absence of supporting value. In addition, extending *Dewsnup* would have negative inter-creditor effects and would give lienholders inappropriate leverage against both debtors and other creditors.

For these reasons, this Court should affirm the decisions below and overrule *Dewsnup* in the process.

ARGUMENT

I. *Dewsnup* was wrongly decided and should be overruled.

A. *Dewsnup* ignored both the plain meaning of the Bankruptcy Code

and established principles of statutory construction.

Dewsnup v. Timm, 502 U.S. 410 (1992), did not quarrel with bifurcation under 11 U.S.C. § 506(a)[2] of an undersecured claim into two claims—a secured claim, measured by the claimholder's "interest" in the collateral; and an unsecured claim, measured by the deficiency. Thus, when a claim is undersecured, the creditor's "allowed secured claim," as that phrase is used in subsection (a), is less than the amount of the debt. *Dewsnup* held, however, that the very same phrase, used in subsection (d), is to "be read term-by-term to refer to any claim that is, first, allowed, and, second, secured." *Dewsnup*, at 415. Thus, the phrase "allowed secured claim," when used in section 506(a), means the claim measured by the value of the collateral, but the same phrase, used in section 506(d), means both parts of an undersecured party's claim—specifically, the full amount allowed under section 502.

This reading violates well-established rules governing statutory interpretation, beginning with the most fundamental rule of all—that plain language should be applied as written. *Lamie v. U.S. Tr.*, 540 U.S. 526, 534 (2004) ("It is well established that when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms." (internal quotation marks omitted)).

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[2] Hereinafter references to the Bankruptcy Code are by section number alone.

A second, closely related, interpretive proposition, to which this Court has repeatedly adhered (*Dewsnup* being the notable counter-example), is the "normal rule of statutory construction" that "identical words used in different parts of the same act are intended to have the same meaning." *IBP, Inc. v. Alvarez*, 546 U.S. 21, 34 (2005); *Dewsnup*, at 422 (Scalia, J., dissenting). *Dewsnup* concluded that "allowed secured claim" has a meaning in subsection 506(d) different from its meaning in another subpart of the very same section, as well as elsewhere in the Code. This Court in other cases, however, has rejected this methodology of statutory construction. See, e.g., *U.S. v. Santos*, 553 U.S. 507, 522 (2008) (rejecting the argument "that one undefined word, repeated in different statutory provisions, can have different meanings in each provision," and "forcefully" rejecting the "interpretive contortion" that "proceeds" in federal money laundering statute can have different meanings "in the same statutory provision"); *Clark v. Martinez*, 543 U.S. 371, 378 (2005) (stating, in determining whether construction of language applicable to one category of inadmissible aliens also applies to another category, that "[t]o give these same words a different meaning for each category would be to invent a statute rather than interpret one").

The *Dewsnup* Court apparently believed that the language in subsection (d) is ambiguous. *Dewsnup* at 416 ("The foregoing recital of the contrasting positions of the respective parties and their *amici* demonstrates that section 506 of the Bankruptcy Code and its relationship to other provisions

of that Code do embrace some ambiguities."). This belief rested solely on the fact of disagreement among self-interested litigants. *Woolsey v. Citibank, N.A. (In re Woolsey)*, 696 F.3d 1266, 1273 (10th Cir. 2012) (*Dewsnup*'s finding of ambiguity was "based on no more than the fact the litigants before it happened to disagree over the statute's meaning"). Were that enough to render statutory language ambiguous, however, the plain meaning rule could never apply in a litigated case. See, e.g., *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 461 (1999) (Thomas, J., concurring in the judgment) ("If litigants' differing positions demonstrate statutory ambiguity, it is hard to imagine how any provision of the Code—or any other statute—would escape *Dewsnup*'s broad sweep. A mere disagreement among litigants over the meaning of a statute does not prove ambiguity; it usually means that one of the litigants is simply wrong.").

Subsequent courts at every level, and many commentators, have found *Dewsnup*'s interpretive methodology unsupportable. See, e.g., *203 N. LaSalle* at 461 (Thomas, J., concurring in the judgment) (referring to *Dewsnup*'s mode of statutory analysis as "methodological error"); *Dewsnup*, at 420 (Scalia, J., dissenting) (stating that the majority "disregards . . . well-established principles of statutory construction"); *Dever v. IRS (In re Dever)*, 164 B.R. 132, 138 (Bankr. C.D. Cal. 1994) ("*Dewsnup's* result is hard to reconcile with the overall structure and language of the Code using normal principles of statutory construction."); David Gray Carlson, *Bifurcation of Undersecured Claims in*

Bankruptcy, 70 AM. BANKR. L.J. 1, 16 (1996) [hereinafter "Carlson, *Bifurcation of Undersecured Claims*"] (characterizing *Dewsnup*'s assignment of different meanings to "allowed secured claim" in §§ 506(a) and (d) as "overt interpretive violence"); Robert M. Lawless, *Legisprudence Through a Bankruptcy Lens: A Study in the Supreme Court's Bankruptcy Cases*, 47 SYRACUSE L. REV. 1, 26, 27 (1996) (referring to *Dewsnup* as a "disaster" and its statutory interpretation methodology as "faux textualism").

Criticism, despite being spot-on and nearly universal, may not be enough to justify the overruling of established precedent that is otherwise supported by Congress's articulated policies. Examination of *Dewsnup*, however, reveals that every premise on which the Court relied was flawed.

B. None of *Dewsnup*'s supporting rationales justifies its outcome.

The *Dewsnup* majority was apparently aware that its statutory methodology was dubious. *Dewsnup*, at 417 (noting its statutory reading was "not without its difficulty"). Thus, the Court sought to justify its conclusion by looking to legislative history and several policy-based concerns. The Court was attempting to reach the "right" result, despite statutory language pointing in a different direction. Reading section 506(d) to permit avoidance of liens unsupported by value, however, is neither absurd nor unconstitutional nor inconsistent with the Bankruptcy Code as a whole.

1. *Dewsnup* is not justified by an undersecured creditor's right to appreciation.

The *Dewsnup* Court was primarily concerned that stripdown would allow bankruptcy debtors to receive a "windfall" by cutting off undersecured creditors' access to future appreciation:

> The practical effect of [debtor's] argument is to freeze the creditor's secured interest at the judicially determined valuation. By this approach, the creditor would lose the benefit of any increase in the value of the property by the time of the foreclosure sale. The increase would accrue to the benefit of the debtor, a result some of the parties describe as a "windfall."

Dewsnup, at 417.

This supposed "windfall" is a complete mirage in most cases. In other cases, when appreciation is conceivable, the Bankruptcy Code provides ready protection for the undersecured creditor's legitimate concerns.

The average chapter 7 case is of relatively short duration.[3] Valuation determined as of filing is

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[3] Administrative Office of the United States Courts, *2013 Report of Statistics Required by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, Table 3 (2014) ("From filing to disposition, chapter 7 consumer cases closed in 2013 had a mean time interval of 212 days and a median time interval of 116 days.").

unlikely to differ in any significant amount from the value of the creditor's interest as of the date of stripdown. If the facts are otherwise in a particular case, however—either because the case is unusually prolonged or because of galloping appreciation—then undersecured creditors' concerns are fully addressed if the property is valued as of the time of lien avoidance, rather than the time of filing. Section 506(a)(1) provides ample authority for determining value, in a rising market, as of the later time: "Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property." Authority is divided,[4] but courts are obviously free to time valuation as necessary to protect creditors' legitimate interests.

This approach provides complete compensation to the creditor for appreciation occurring up to the moment its secured claim is valued and paid, as well as for the likelihood of future appreciation. Under established principles governing appraisals and valuation, the likelihood of appreciation is accounted for in proper valuation of any type of property:

> [P]roper valuation subsumes all projections of future movements in the market. Such a valuation contemplates the possibility of an upside and a downside in future property values. If the property goes up in value, the

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[4] *Dewsnup* itself suggests the avoidance date, observing that postpetition appreciation "rightly accrues to the benefit of the creditor," *Dewsnup*, at 417; but section 502(b) states that courts shall determine the amount of claims to which objection is raised, "as of the date of the filing of the petition."

> secured party has already been compensated in the original valuation and therefore does not deserve the newly found surplus.

Carlson, *Bifurcation of Undersecured Claims*, at 17. See also Theodore Eisenberg, *The Undersecured Creditor in Reorganizations and the Nature of Security*, 38 VAND. L. REV. 931, 946 n.45 (1985) [hereinafter "Eisenberg, *Undersecured Creditor*"] ("An accurate appraisal would, of course, reflect the possibility of a future increase or decrease in value."); Int'l Valuation Standards Council, INT'L VALUATION STANDARDS 2013: FRAMEWORK AND REQUIREMENTS ¶ 103 (requiring, in valuing real property for purposes of secured lending, consideration of factors suggesting future increases in value: "anticipated future demand for the type of property and location," "potential . . . alternative uses that . . . can be anticipated," and "impact of any events foreseeable at the valuation date on the probable future value").

Thus, payment of the value of the secured claim, determined as of the appropriate moment, fully compensates the claimholder for appreciation occurring postpetition and pre-avoidance, as well as for the likelihood of future appreciation. Furthermore, the cashed-out creditor has complete control over the actual capture of additional future appreciation because that creditor can simply reinvest the proceeds in the rising market.

Even with their *in rem* rights intact, creditors may be unable to hold property and await appreciation. First, statutes and regulations restrict the

ability of many real estate lenders to speculate on future appreciation by bidding in the amount of their debts and holding property. See, e.g., 7 C.F.R. § 1955.102 (2014) (providing, upon foreclosure of FHA loans secured by real estate, that "[s]ales efforts will be initiated as soon as property is acquired in order to effect sale at the earliest practicable time"); 38 C.F.R. § 36.4283(f) (2014) (providing, upon foreclosure of loans guaranteed by VA, that the holder "shall resell the property within a reasonable time"). Second, foreclosed real estate held for appreciation may decrease a lender's ability to make other loans. See, e.g., 12 U.S.C. §§ 1464(c)(2) & (t)(1)(A) (2014) (limiting loans made by federal savings associations and secured by nonresidential real property to 400% of association's capital, and defining capital to account for nonproductive loans).

The stripped-down creditor suffers no more violation of its legitimate interests than does a seller who receives the price of its product in a rising market. The bankruptcy debtor enjoys no more of a "windfall" than does a buyer, when each pays the appropriate value of acquired property, as of the time of acquisition.

The key is that the stripped-down creditor receive the full amount of its interest. Tellingly, petitioner did not contest the bankruptcy courts' valuation determinations in either of the present cases. Brief for Respondents at 6.

Congress's concern about an undersecured creditor's access to appreciation is reflected in one and only one provision of the Bankruptcy Code—

section 1111(b). It was designed to reverse the result reached in a single pre-Code case, *In re Pine Gate Associates, Ltd.*, 2 B.C.D. (CRR) 1478 (Bankr. N.D. Ga. 1976), which permitted the debtor to pay the collateral's appraised value and to keep the property free of lien. Examination of section 1111(b) reinforces that Congress intended to protect only the *value* of liens and, additionally, only liens *with* value.

Creditors were unhappy about *Pine Gate* because, in part, they could not bid in the amount of their debts in the absence of public sale. Section 1111(b), therefore, permits an undersecured creditor to "elect" to have a secured claim measured by the amount of the debt rather than the value of the collateral, thus being treated as fully secured.

Ordinarily, chapter 11 provides that a debtor may satisfy an undersecured claim by paying the amount supported by value—that is, the "allowed secured claim"—plus interest, if payments are made over time, in order to provide present value as of the time the secured claim is satisfied.[5] Thus, if the

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[5] Absent the election, chapter 11 requires a stream of payments meeting two tests: first, a "principal amount" test, requiring "deferred cash payments totaling at least the allowed amount of" the claim; and second, a "present value" test, requiring payments having "a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property." § 1129(b)(2)(A)(i). The present value test effectively requires debtors to pay interest, at an appropriate rate, when payments are made over time. Cf. *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004).

The apparent redundancy of the requirements is necessary in order to accommodate the possibility of election.

debtor owes the creditor $25,000 and the obligation is secured by a lien on collateral worth $10,000, without the election the debtor must make payments of at least $10,000, plus appropriate interest. With the election, however, our debtor must make payments having a face amount of at least $25,000 and a present value of at least $10,000.

The section 1111(b) election assures that the undersecured creditor will enjoy the benefit of any appreciation to the property. Eisenberg, *Undersecured Creditor*, at 939 (stating that, upon election, the creditor "retains a right to enjoy future appreciation in the collateral or to compensate for an initially low appraisal"). The section 1111(b) election, therefore, answers *Dewsnup*'s concern about undersecured creditors' access to appreciation, but only in chapter 11 cases. In the absence of the election, stripdown is as permissible in chapter 11 cases as it is elsewhere.

Although the section 1111(b) election appears beneficial to creditors, it does not actually require that the debtor pay more in terms of economic value than the collateral's worth. If payments extend for a sufficient period of time, the present value of payments having a face amount equal to the debt ($25,000, in the example) can, in fact, be made to equal the value of the collateral ($10,000). Assume, for purposes of illustration, that our debtor proposes to pay the creditor interest only, annually, at the rate of 10% for 15 years, with a balloon payment of $10,000 at the end of that time. If 10% is an appropriate rate, the stream of payments will have a face amount of $25,000 ($1,000 per year for 15 years,

plus a balloon of $10,000), but a present value of only $10,000.

Three points are evident. First, Congress knew how to address concerns about appreciation when it had them. Second, stripdown is entirely permissible when the election either is not made or is unavailable. Third, even when at its creditor-protective best, Congress did not mandate that the undersecured creditor receive more than the economic value of its interest in collateral, even when its claim has some monetary value. When it does not—when the claim "is of inconsequential value"—the election is unavailable. § 1111(b)-(1)(B)(i). Petitioner would have this Court exceed what Congress was willing to do when treating undersecured creditors most favorably (and import it into chapter 7 as well).

Dewsnup's concern with postpetition appreciation was entirely misplaced. Every undersecured creditor is fully protected by proper valuation, made at the appropriate time, and by the opportunity to reinvest in the rising market. Congress required no more than that.

2. *Dewsnup* erroneously believed that liens pass through bankruptcy unaffected.

Dewsnup believed that the rule under pre-Code law—"liens pass through bankruptcy unaffected"—survived passage of the Code. *Dewsnup*

cited two recent cases[6] as well as the venerable decision of *Long v. Bullard*, 117 U.S. 617 (1886). *Dewsnup*, at 417. In so doing, *Dewsnup* grossly mischaracterized all three cases.[7]

In *Long v. Bullard*, a mortgage holder who had not participated in bankruptcy sought to enforce his lien against the debtor's exempt residence after the case closed. The issue in *Long* was whether discharge in bankruptcy eliminates only a creditor's

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[6] *Dewsnup* cited *Farrey v. Sanderfoot*, 500 U.S. 291 (1991), and *Johnson v. Home State Bank*, 501 U.S. 78 (1991), each of which cited *Long*.

[7] The issue in *Farrey* was whether a lien, granted pursuant to a divorce decree that extinguished the parties' prior interests, is avoidable under section 522(f). The Court held no, citing *Long* for the slightly different, "particular" proposition that valid liens can be enforced against exempt property. 500 U.S. at 297. It is not at all evident that *Farrey* cited *Long* for the general rule, stated in *Farrey*'s prior sentence, that liens "ordinarily" survive bankruptcy. In any event, *Farrey* did involve lien avoidance, but in the context of deciding what liens fall within statutory language entirely unlike section 506(d).

In *Johnson*, the Court foreshadowed *Dewsnup*'s error by citing *Long* for the bare proposition that liens pass through bankruptcy. 501 U.S. at 84.

Some of the language in *Johnson* suggests that chapter 7 does not affect a creditor's nonbankruptcy right to enforce its lien. See *id.* ("[B]ankruptcy discharge extinguishes only one mode of enforcing a claim—namely, an action against the debtor *in personam*—while leaving intact another—namely, an action against the debtor *in rem*."). Reading *Johnson* in that way, however, requires taking its language out of context. The issue in *Johnson* was whether a *valid* lien that survives chapter 7 constitutes a "claim" in a subsequent chapter 13, and the Court decided in the affirmative. *Johnson* did not involve bankruptcy's power to avoid liens.

recourse against the debtor or recourse against the collateral as well. *Long* held that discharge only affects a debtor's personal liability and does "not relieve the property from the operation of liens created by contract before the bankruptcy." 117 U.S. at 620. *Long* addressed the effect of discharge, and its holding remains valid—discharge only affects a debtor's personal liability. See § 522(c) (providing that exempt property remains liable for debts secured by unavoided liens); § 524(a)(1) (providing that discharge affects only "the personal liability of the debtor").

Long dealt with the scope of discharge; it did not present a question of lien avoidance. Rather, *Long* presumed the validity of the lien at issue. To cite *Long* for the proposition that "liens pass through bankruptcy" is to perpetuate a deeply misleading half-truth. Accurately stated, *Long* stands for the proposition—unremarkable today—that valid liens are enforceable postbankruptcy. *Long* does not support the proposition that liens could not be reduced under pre-Code law for reasons other than payment of the full debt. *Long* says nothing about bankruptcy's power to avoid liens, then or now.[8]

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[8] Under pre-Code law, *valid* liens were unaffected by bankruptcy. Section 67(d) of the 1898 Bankruptcy Act said so expressly until amended by the Chandler Act in 1938. Pub. L. No. 55-541, 30 Stat. 544, *amended by* Pub. L. No. 75-696, 52 Stat. 840 (1938) (repealed 1978). Thereafter, courts understood that no change in the law was intended. See *Oppenheimer v. Oldham*, 178 F.2d 386, 389 (2d Cir. 1949) ("It has always been a fundamental principle of the bankruptcy law that the property rights and interests designated as liens and pledges, *when valid in bankruptcy*, shall not be impaired in the administration of a bankrupt estate. The Chandler Act manifests no intent to

3. *Dewsnup* misread *Radford* and the line of cases to which it belongs.

Dewsnup cited *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935), to suggest that stripping a lien down to its supporting value raises constitutional concerns. By citing only *Radford* and failing to note subsequent cases, *Dewsnup* gave a misleading impression of this Court's holdings relevant to bankruptcy's treatment of secured claims. *Dewsnup* also mischaracterized *Radford* as a lien-stripping case when, in fact, that case presented a takings question.

Radford interpreted the Frazier-Lemke Act, Pub. L. No. 73-486, 48 Stat. 1289 (1934), which was designed to provide relief to farmers—a group especially hurt by the Great Depression. *Dewsnup* correctly noted that the Act's "avowed object is to take from the mortgagee rights in the specific property held as security; and to that end 'to scale down the indebtedness' to the present value of the property." *Dewsnup*, at 419 (quoting *Radford*, at 594). That was only a partial statement of the Act's effects, however. It did much more. It effectively allowed the debtor to purchase property, free of liens predating the Act, at appraised value—*i.e.*, an amount less than the debt—by making payments

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deviate from that principle." (emphasis added)). *Dewsnup* cited *Oppenheimer*, 502 U.S. at 418 n.4, oblivious that the adage—"liens pass through bankruptcy"—applies only to liens not avoided in the bankruptcy case. Nor did *Dewsnup* acknowledge the bankruptcy sea-change made by the Code. See *infra*, pp. 20-26.

over time, without interest. This, according to *Radford*, amounted to a retroactive taking of the mortgagee's property without just compensation.

Congress amended the Frazier-Lemke Act almost immediately after *Radford*. Pub. L. No. 74-384, 49 Stat. 942 (1936). This Court found the revised Act to pass constitutional muster in a series of cases: *Wright v. Vinton Branch Bank*, 300 U.S. 440 (1937) (*Wright I*); *Wright v. Union Central Life Ins. Co.*, 304 U.S. 502 (1938) (*Wright II*); and *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940) (*Wright III*). These cases unquestionably limited *Radford*.

In *Wright I*, the Court identified retroactivity as the constitutional infirmity of the original Frazier-Lemke Act:

> The decision in the *Radford* case did not question the power of Congress to offer to distressed farmers the aid of a means of rehabilitation under the bankruptcy clause. The original Frazier-Lemke Act was there held invalid solely on the ground that the bankruptcy power of Congress, like its other great powers, is subject to the Fifth Amendment; and that, as applied to mortgages given before its enactment, the statute violated that Amendment, since it effected a substantial impairment of the mortgagee's security.

300 U.S. at 456-57.[9] And in *Wright III*, the Court held that a bankruptcy statute permitting the debtor to purchase encumbered property by paying its current value does not violate constitutionally-protected rights of the mortgagee: "Safeguards were provided to protect the rights of secured creditors, throughout the proceedings, to the extent of the value of the property. . . There is no constitutional claim of the creditor to more than that." 311 U.S. at 278.

Radford, taken alone, misstates this Court's constitutional holdings regarding secured claims. Under those holdings, a secured creditor, paid the present value of its collateral, has no sustainable constitutional complaint, notwithstanding *Dewsnup*'s intimations to the contrary. Congress read the *Radford-Wright* line of cases to require that a secured creditor receive every penny of the value available to support its claim, but no more. This constitutional mandate became bankruptcy's touchstone.

4. *Dewsnup* misunderstood the intent of Congress and structure of the Bankruptcy Code.

Plain text must control, unless "demonstrably at odds" with legislative intent. *U.S. v. Ron Pair Enterps. Inc.*, 489 U.S. 235, 241 (1989). Legislative history relevant to these cases, however, reveals that

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[9] Retroactivity remained a concern under the Code. In *United States v. Security Industrial Bank*, 459 U.S. 70 (1982), the Court held that section 522(f), which permits avoidance of certain liens impairing a debtor's exemptions, cannot be applied retroactively. The cases at bar involve no issue of retroactivity.

Congress meant exactly what the statute plainly says.

a. Congress adopted a "priority model" of secured creditors' rights in bankruptcy.

The Code provides that a lienholder, upon valuation of the collateral in accordance with bifurcation under section 506(a), is entitled either to its collateral or to the value of that collateral (again, with interest, if necessary). Congress, in effect, adopted a "priority" view[10] of the rights of secured creditors.[11] This model requires that the holder of a secured claim receive the value of supporting collateral; it does not permit creditors to assert rights to a specific piece of property.

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[10] Mary Josephine Newborn, *Undersecured Creditors in Bankruptcy:* Dewsnup, Nobelman *and the Decline of Priority*, 25 ARIZ. ST. L.J. 547, 556 n.26 (1993) [hereinafter "Newborn, *Undersecured Creditors*"] ("Under a "priority" notion of security, "security" means a right not to a specific piece of collateral, but simply a right to be paid first to the extent of the value of the collateral.").

[11] See generally Newborn, *Undersecured Creditors*, at 578 ("Under the [1898] Act, security represented a concept closer to a right to a particular piece of collateral and the right to exercise nonbankruptcy collection rights . . The drafters of the Code promulgated an approach based upon priority." (footnote omitted)); Lawrence Ponoroff & F. Stephen Knippenberg, *The Immovable Object Versus the Irresistible Force: Rethinking the Relationship Between Secured Credit and Bankruptcy Policy*, 95 MICH. L. REV. 2234 (1997) [hereinafter "Ponoroff & Knippenberg"], at 2272-73 (noting that the Code adopted "the principle that the secured creditor's rights were limited to the value of its collateral rather than to a possessory interest in the collateral itself." (footnotes omitted)).

Congress codified the priority model consciously and intentionally:

> One of the more significant changes from current law in proposed title 11 is the treatment of secured creditors and secured claims. Unlike current law, [the bill] distinguishes between secured and unsecured claims, rather than between secured and unsecured creditors. The distinction becomes important in the handling of creditors with a lien on property that is worth less than the amount of their claim, that is, those creditors that are undersecured. Current law is ambiguous and vague, especially under chapter XIII, on whether an undersecured creditor is to be treated as a secured creditor, or as a partially secured and partially unsecured creditor. By addressing the problem in terms of claims, the bill makes clear that an unsecured creditor is to be treated as having a secured claim to the extent of the value of the collateral, and an unsecured claim for the balance of his claim against the debtor.

H.R. REP. NO. 595, 95th Cong., 1st Sess. 180-81 (1977) [hereinafter "H.R. REP. NO. 95-595"]. Commentators, then and later, understood that the Code had adopted a priority model in dealing with the rights of secured creditors in bankruptcy.[12]

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[12] See, e.g., Charles A. Shanor, *A New Deal For Secured Creditors in Bankruptcy*, 28 EMORY L.J. 587, 595 n.39 (1979) ("The Code's focus on the value of the secured party's claim

b. Congress intended to protect only the value of secured claims.

Never in the process of revision did Congress even hint that *in rem* rights are sacrosanct. Quite the opposite. Multiple sections of the Code are consistent with a priority view of secured creditors' rights.

The first of these is section 506(a) itself. Bifurcation became necessary when Congress chose to protect only the value of a secured claim. *Dewsnup* failed to realize that section 506(a) is definitional, intended to define the meaning of a "secured claim" throughout the Code, for all purposes:

> *Throughout the bill,* references to secured claims are only to the claim determined to be

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rather than on the security itself is a substantial change from both the Act and the U.C.C."); Peter F. Coogan, *Article 9—An Agenda for the Next Decade*, 87 YALE L.J. 1012, 1028-30 (1978) (indicating that then-new Bankruptcy Code viewed a secured party's interest as a prior claim against specific assets rather than as "property rights"); Douglas Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97, 113 (1984) ("A secured creditor's property right is limited in its scope by its purpose, which is to implement the secured creditor's priority right."); Eisenberg, *Undersecured Creditor*, at 952 ("This view translates secured status into a priority claim equal to the value of the creditor's collateral, which alone is the measure of the value of the creditor's secured status in bankruptcy.").

> secured under this subsection [section 506(a)], and not to the full amount of the creditor's claim. This provision abolishes the use of the terms "secured creditor" and "unsecured creditor" and substitutes in their places the terms "secured claim" and "unsecured claim."

H.R. REP. NO. 95-595, at 356 (emphasis added). Thus, wherever the phrase "secured claim" appears in the Code, it carries this post-bifurcation meaning (with a handful of statutory exceptions and the exception of section 506(d) as interpreted by *Dewsnup*).

Adherence to the mandate of the *Radford-Wright* line of cases—that a secured creditor receive the value of its secured claim—also necessitated that such claims be protected from erosion during the case. This function is served by section 361, which sets out a nonexclusive list of ways an otherwise-deteriorating secured claim can be maintained. Adequate protection can come from: cash payments, § 361(1); a lien on additional or different property, § 361(2); or anything else assuring that the creditor will receive the "indubitable equivalent" of the value of the collateral supporting its claim, § 361(3).

Section 361 clearly protects the creditor's right to the value of its collateral, but not any right to the property itself. Nowhere is a secured creditor given a right to insist upon *in rem* realization against its pre-bankruptcy collateral. Instead, such an entity is assured of receiving the value of its collateral, with-

out reduction by postpetition depreciation,[13] and nothing more. The House Report was quite specific on this point:

> The section [361], and the concept of adequate protection, is based as much on policy grounds as on constitutional grounds. Secured creditors should not be deprived of the benefit of their bargain. There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the bankruptcy laws. Thus, this section recognizes the availability of alternate means of protecting a secured creditor's interest. Though the creditor might not receive his bargain in kind, the purpose of the section is to insure that the secured creditor receives in value essentially what he bargained for.
>
> The section specifies four means of providing adequate protection. They are neither exclusive nor exhaustive. They all rely, however, on the value of the protected entity's interest in the property involved.

H.R. REP. NO. 95-595, at 339.

This legislative history supports three interrelated propositions: first, the secured creditor is

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[13] Charles J. Tabb, BANKRUPTCY 294 (3d ed. 2014) (stating that section 361 protects creditors from a decrease in value of their interests "caused by the imposition of the bankruptcy case, during the pendency of the case").

entitled to the value of its collateral as a matter of constitutional right;[14] second, this value is to be protected from erosion during the case; and third, what Congress meant by "the benefit of the bargain" is that the undersecured creditor can claim the value of its position, not the collateral itself.

In the face of sweeping change, legislative itemization is too much to expect. See, e.g., *U.S. v. Ron Pair Enters.*, 489 U.S. 235, 240-41 (1989) ("In such a substantial overhaul of the system, it is not appropriate or realistic to expect Congress to have explained with particularity each step it took."). Here, however, we have particularity. This legislative history refutes one of *Dewsnup*'s major rationales—namely, that Congress must not have meant to change pre-Code treatment of undersecured creditors because the legislative history makes no such mention. In fact, legislative history indicates Congress's intent to bring undersecured creditors within bankruptcy's reach to a significant degree, and for the first time.[15] Contrary to prior

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[14] The legislative history cited both *Radford* and *Wright III*: H.R. REP. NO. 95-595, at 339 ("The concept [of adequate protection] is derived from the fifth amendment protection of property interests as enunciated by the Supreme Court. See *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935).").

[15] Commentators so understood at the time the Code was enacted. See Frank R. Kennedy, *Secured Creditors Under the Bankruptcy Reform Act*, 15 IND. L. REV. 477, 486-87 (1982) ("The Bankruptcy Reform Act is more explicit in regard to the rights of secured creditors than any previous bankruptcy legislation.").

practice, a court can now deny an undersecured creditor access to its collateral, provided that the creditor receive adequate protection for the value of its interest. This development fits hand in glove with a jurisprudence of bifurcation.

c. The Code's structure is consistent with a priority understanding of secured creditors' rights.

Other provisions, found across the Code, consistently use "secured claim" to mean the post-bifurcation amount, as determined under section 506(a). These provisions are also consistent with the priority view, replacing a secured creditor's rights against collateral with assurance that the creditor will receive the value of those rights.

First, section 364(d) authorizes a court to trump an existing secured claim by imposing a new lien having equal or even senior priority. This is an extraordinary power, exercisable only when necessary postpetition credit cannot be obtained in a less intrusive manner. The demoted creditor can look only to section 361 for adequate protection, however; it cannot appeal to its *in rem* rights under state law. Thus, under sections 361 and 364, the secured creditor's rights are not tied to access to specific collateral.

Second, section 722 permits an individual debtor to redeem consumer personalty "by paying the amount of the allowed secured claim . . . in full, at the time of redemption." The creditor cannot insist on retaining its lien until the debt is satisfied,

although that is exactly what state law requires. Congress was aware that this section gives debtors broader rights than state law provides. See H.R. REP. NO. 95-595, at 380 ("This section [722] is new and is broader than rights of redemption under the Uniform Commercial Code."). Congress here reiterated that the creditor's bargain extends only to the value of available collateral, noting that section 722 "does not prevent the creditor from obtaining what he is entitled to under the terms of his contract." *Id.*

Third, section 506(b), which gives an over-secured creditor rights to postpetition interest, extends only to the value of the collateral. 4 COLLIER ON BANKRUPTCY ¶ 506.04[1], at p. 506–95 (16th ed. 2014) ("For purposes of section 506(b), an 'allowed secured claim' is an allowed claim that qualifies as a secured claim as provided under section 506(a)."). Once that value is consumed, no more postpetition interest can be added to the claim. *Id.* at ¶ 506.049[2], at p. 506–98.

Finally, plan confirmation provisions under the reorganization chapters require payment of no more than the present value of the secured claim. Chapters 12 and 13 provide that the nonconsenting holder of an "allowed secured claim" retain its lien and receive property with a present value of "the allowed amount of such claim." § 1225(a)(5)(B); § 1325(a)(5)(B)(ii). The requirements for chapter 11 are similar, although with more complicated wording. See *supra*, p. 11-14. Under each of these provisions, nonconsenting secured creditors generally must receive a stream of payments with a

face amount and present value equal to the amount of the claim. That assures an undersecured creditor the value of the collateral, with interest when necessary.

In all of these provisions, the Bankruptcy Code is consistent with a priority view of secured creditors' rights, entitling them to the *value* of the collateral supporting their liens, no more and no less.

This is not to say that Congress intended no exceptions. When exceptions appear, however, they are clearly drawn. They also cut both ways, sometimes allowing elimination of liens fully supported by value and occasionally providing more generous treatment to an undersecured creditor.

Exceptions in the former category permit avoidance of liens with economic value—that is, "secured claims," as defined by section 506(a). Examples include: section 547, permitting avoidance of liens arising shortly before bankruptcy, when given to secure pre-existing debts; section 548, allowing avoidance of certain transfers and obligations on the grounds of constructive fraud, evidenced by the debtor's having made a transfer or incurred an obligation for less than reasonably equivalent value within two years before bankruptcy; section 545, permitting avoidance of designated statutory liens; and section 522(f)(1), enabling the debtor to avoid judicial liens, as well as nonpossessory, nonpurchase money security interests in

specified categories of property, if those encumbrances impair the debtor's exemptions.[16]

Exceptions in the latter category use targeted language to extend additional rights and protections to holders of particular secured claims. One such provision, section 1111(b), has already been discussed. See *supra*, p. 11-14. Another—section 1322(b)(2), as interpreted by this Court in *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993)—protects the rights of creditors holding claims secured by the debtor's residence. *Nobelman* interpreted section 1322(b)(2) to prevent stripdown of the undersecured creditor's lien, effectively reading section 1322(b)(2) as an exception to the otherwise-applicable rule of sections 506(a) and (d). That decision rested on the statute's reference to "rights" rather than "claims."

More recently, Congress added protections for undersecured creditors whose interest in the debtor's automobile arose within 910 days of bankruptcy, and for undersecured creditors who took an interest in "any other thing of value" within a year before bankruptcy. § 1325(a)(*) (*added by* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 306(b), 119 Stat. 80-81). In

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[16] In these instances, bankruptcy voids liens *with* supporting value, and does so with no constitutional taint whatsoever. Cf. James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 1031 (1983) ("The only significant constitutional restraint on the substance of purely prospective bankruptcy legislation is the bankruptcy clause itself.").

order to create this additional protection, Congress was very careful to render section 506 inapplicable, stating that "section 506 shall not apply" in those fact patterns. This provision (known as the "hanging paragraph") prevents bifurcation of an undersecured claim in chapter 13 cases—the very effect *Dewsnup* achieved in the absence of clear language such as that added in 2005, and for all undersecured creditors in chapter 7 cases.

Also in 2005, Congress added a requirement in chapter 13 that a lien remain in place until full repayment of the debt or the debtor's discharge. § 1325(a)(5)(B)(i)(I). That enables an undersecured creditor to retain its lien until the debt has been repaid, when the debtor is ineligible for discharge. See *Colbourne v. Ocwen (In re Colbourne)*, 550 Fed. Appx. 687 (11th Cir. 2013).

When Congress wanted to protect an undersecured claim from stripdown, it expressly provided exceptions to the otherwise-applicable rules of sections 506(a) and (d). Some of these provisions apply only in reorganization proceedings, some only in liquidations, and others only in cases concerning individual debtors. But nothing in the legislative history, or the structure of the Code itself, suggests that the fundamental rights of secured creditors depend on whether the bankruptcy proceeding at issue is a reorganization or a liquidation.

d. *Dewsnup* erroneously believed that Congress followed pre-Code rules, permitting stripdown only in reorganization cases.

The *Dewsnup* Court pointed to pre-Code law permitting stripdown only in reorganization cases, and concluded that "Congress must have enacted the Code with a full understanding of this practice." *Dewsnup*, at 419. That is true, but Congress's "full understanding" cut entirely the other way.

First, Congress intended to make "significant changes from current law in . . . the treatment of secured creditors and secured claims," H.R. REP. NO. 95-595, at 180, as described above. See *supra*, pp. 19-30. Reliance on pre-Code law is particularly perilous given the wholesale rewriting of bankruptcy law in 1978.

Second, Congress intended the Code to repair the inefficacy with which pre-Code law handled consumer cases: "The current Bankruptcy Act, last revised in any major way in 1938, was not designed to provide adequate relief to the consumer debtor. The primary thrust of the 1938 revision was toward business bankruptcies, because consumer bankruptcy was not a significant factor in the 1930's." H.R. REP. NO. 95-595, at 116-17. Congress did not address these deficiencies by drawing distinctions between business and consumer cases, however. The bill made "no such distinction." *Id.* at 6. Instead, "provisions of chapter 7 . . . apply equally to business and consumer cases" and "provisions in the generally applicable chapters, 1, 3, and 5, are not divided along consumer/business lines." *Id.* When rules need to apply differently in consumer and business cases—or, one might add, in liquidation and reorganization cases—the Code says so expressly. Otherwise,

generally applicable provisions, such as sections 506(a) and (d), apply across the universe of bankruptcy cases.

Dewsnup rests ultimately on a belief that the fundamental rights of secured creditors are different, depending upon whether the debtor is in a liquidation or reorganization proceeding. Although pre-Code law focused on reorganizations, the Code adopted rules that apply across all bankruptcies. Thus, *Dewsnup* completely misread the purposes of Congress, as expressed in the statute and its legislative history. Unless the Code says otherwise, it protects a secured creditor's interest only to the extent of the value of available collateral, and it draws no distinction between rules generally applicable to liquidations and those applicable to reorganizations.

II. Even if *Dewsup* is not overruled, it should not be extended to liens wholly underwater.

Even if this Court is unwilling to overrule *Dewsnup*, despite the poverty of its statutory reading and supporting rationale, *Dewsnup* should not be extended to protect liens wholly devoid of value.

A. The Code, as interpreted by *Dewsnup*, does not protect liens devoid of supporting value.

The Code provides a basis for confining *Dewsnup* to the realm of chapter 7 claims supported by

some modicum of value.[17] *Dewsnup* read each of the terms in section 506(d)—"allowed," "secured" and "claim"—independently, and concluded that a claim cannot be stripped down, in a chapter 7 case, as long as it meets all three requirements. The Court found the definitions of "allowed" and "claim" in the Code, in sections 502 and 101(5) respectively. The definition of "secured" must be found there as well, and the only possibility is section 506(a). Under its express language, no claim can be secured in the absence of some amount of supporting value, and *Dewsnup* rested on the existence of a secured claim in the first place.

Post-*Dewsnup*, this Court has looked to section 506(a) as the starting point. In *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993), the Court stated that the debtors "were correct in looking to section 506(a) for a judicial valuation of the collateral to determine the status of the bank's secured claim." *Id.* at 328. This implicitly acknowledges that, in the absence of supporting value, there can be no "secured" claim for purposes of *Dewsnup*'s protection. The mortgages held by petitioner do not qualify.

That Congress intended no protection for a valueless lien is made express in section 361, which requires adequate protection only to the extent of an "entity's interest" in property.[18] The legislative

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[17] So, too, does *Dewsnup* itself. *Dewsnup*, at 417 ("We . . . focus upon the case before us and allow other facts to await their legal resolution on another day.").

[18] Congress was specific when it wanted a different result in chapter 12. See § 1205 (prohibiting, in chapter 12 cases, a

history is even clearer, stating that all of the methods of providing adequate protection "rely . . . on the value of the protected entity's interest in the property involved." H.R. REP. NO. 95-595, at 339. Since the creditor's "interest" is to be protected under section 361 against a decline in value, adequate protection is not required when a lien is already valueless. This Court recognized decades ago, in a case involving similar statutory provisions, that valueless liens have no position to protect. In *In re 620 Church Street Building Corp.*, 299 U.S. 24 (1936), holders of valueless liens (citing *Radford*) protested the plan's failure to provide them a distribution:

> Petitioners insist that . . . their claims should have been accorded "adequate protection." But the adequate protection to which the statute refers is "for the realization of the value of the interests, claims or liens" affected. Here the controlling finding is not only that there was no equity in the property above the first mortgage but that petitioners' claims were appraised by the court as having "no value." There was no value to be protected. This finding embraces whatever interests petitioners may have as junior lienors under the Illinois law and, in the same aspect, the constitutional argument is unavailing as petitioners have not shown injury.

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grant of "the indubitable equivalent of [an] entity's interest" pursuant to section 361(3)).

Id. at 27. The Bankruptcy Code, following pre-Code law, expressly provides no protection for petitioner's valueless liens.

B. Extending *Dewsnup* to protect liens devoid of supporting value would have negative inter-creditor effects, and give lienholders inappropriate leverage against debtors and other creditors.

Dewsnup focused on the relationship between the debtor and one creditor, and sought to prevent a windfall for the debtor at the expense of that creditor. Debtors enjoy no "windfall" by virtue of stripdown even when a lien is partially secured, *Dewsnup* to the contrary notwithstanding. See *supra*, pp. 8-11. When liens are without any value, however, extending *Dewsnup* to prevent stripoff of the valueless lien would create negative inter-creditor effects.

A junior creditor retaining a valueless lien can compel a post-bankruptcy foreclosure that will produce not one dime for the moving creditor. If the junior creditor does not buy the property, the senior creditor will bid in its debt, leaving nothing for the junior lienholder and simultaneously accomplishing what *Dewsnup* prohibited—elimination of the subordinate lien. See Baxter Dunaway, 2 LAW OF DISTRESSED REAL ESTATE § 26:23 (2014), *available at* Westlaw LAWDRE ("When a senior lender forecloses, the junior lender's lien is in danger of being eliminated or 'sold-out' if there is no surplus from the sale by the senior."). If the junior creditor

does desire to purchase the property at foreclosure, however, it cannot merely bid in its debt; rather, the junior creditor will have to put real money on the table, in an amount sufficient to satisfy the first mortgage. *Id.* It strains credulity to believe that a junior lienholder, already deeply underwater, would extend its losses in that way.

Any plea for a right to capture appreciation in such cases is an empty shibboleth. Taking the steps required for ownership—necessary in order to reach appreciation, but economically irrational—would alone produce no return. Appreciation even in an amount equal to the total of both debts—an astronomical improvement—would accomplish nothing other than elimination of loss; the junior creditor would still have no gain. And, as discussed above, *supra*, p. 10-11, regulatory rules and statutes may not permit the creditor to hold the property and hope.

Retention of a valueless lien does have one reasonable possible use, however—as leverage, to extract value from the debtor as the price for releasing the lien. The creditor with skin in the game is the holder of the first mortgage. That creditor may choose, for its own reasons, to allow the debtor to retain residential property in exchange for reaffirmation of the debt. But that strategy requires the junior lienholder to release its lien. That lien, devoid of economic value, now has leverage value.

Nothing is served by structuring such a consequence. Legitimate business interests of a creditor with money at stake, who prefers reaffirmation to

foreclosure, should not be upended by a creditor who could not realize even a nickel by pursuing its state law rights. This would produce in bankruptcy an outcome markedly different from the outcome under state law, contravening this Court's repeated admonitions and putting a windfall, now real, in the other pocket. See *Patterson v. Shumate*, 504 U.S. 753, 764 (1992) (noting that enforcing in bankruptcy statutes applicable outside, "minimizes the possibility that creditors will engage in strategic manipulation of the bankruptcy laws in order to gain access to otherwise inaccessible funds").

Nor is bankruptcy policy advanced by putting such leverage in the hands of a creditor with no economic stake in the very lien it so assiduously attempts to retain. In two other contexts, Congress identified the exercise of such leverage as an abuse bankruptcy should prohibit, and enacted provisions designed to do just that: section 522(f), allowing the debtor to avoid nonpossessory, nonpurchase money security interests on designated categories of property; and section 722, discussed *supra*, pp. 26-27. Congress sought to counter creditors' efforts to compel repayment by threatening to repossess items with minimal value in the creditor's hands, but high replacement costs. See H.R. REP. NO. 95–595. at 127. Successful use of such leverage would also violate bankruptcy policy by overcompensating the creditor, enabling a greater return than that attainable under nonbankruptcy law.

CONCLUSION

Providing debtors a "fresh start" is not a mere slogan; it is consumer bankruptcy's defining principle. See H.R. REP. NO. 95-595, at 114 ("[A] fresh start for the debtor . . . is the essence of modern bankruptcy law"); *id.* at 118 ("[B]ankruptcy relief should be effective, and should provide the debtor with a fresh start."). So, too, is bankruptcy's design to protect the value of a secured creditor's rights, but not the rights themselves.

Petitioner wants to preserve a right to foreclose despite the lack of return, even upon resale at arms' length in a retail market.[19] Since petitioner is almost certainly going to receive exactly the same amount from these liens, whichever way this case is decided, one should wonder what is really going on. Whatever it is, for petitioner it is not about realizing any value from these mortgages.

Much is made of the "bargain" here, Brief for Petitioner at 22, 26, 28, but agreements have two sides. Petitioner would have us believe that these debtors agreed to a bargain that, despite bankruptcy's protections, will cost them their homes although it profits this bank nothing.

This Court should affirm the decisions below, and overrule *Dewsnup* in the process.

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[19] One might wonder, as did the Court in *United Savings Association v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 375 (1988), "why Congress would want to provide relief for such an obstreperous and thoroughly unharmed creditor." Here, as there, Congress did not.

Respectfully submitted,

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